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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20054

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of:	)	
	)	
1993 Annual Access Tariff Filings	)	CC Docket No. 93-193, Phase I, Part 1
1994 Annual Access Tariff Filings	)	CC Docket No. 94-65
AT&T Communications Tariff F.C.C. Nos. 1 and 2 Transmittal Nos. 5460, 5461, 5462 and 5464	)	CC Docket No. 93-193. Phase II
	)	CC Docket No. 94-157
Bell Atlantic Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 690	)	
NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 328	)	

Direct Case of Ameritech

Ameritech[1] submits this direct case in response to the Commission's order designating issues for investigation in the above combined docket.[2]

Issue A:

Have AT&T and the individual LECs correctly, reasonably and justifiably calculated the gross amount of SFAS-106 costs that may be subject to exogenous treatment under price cap regulation?

Response A:

Exogenous Claim

1. Date the company implemented SFAS-106:

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[1] Ameritech means: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

[2] Order Designating Issues for Investigation, DA 95-1485 (released June 30, 1995) ("Designation Order").

As Ameritech previously notified the Commission,[3] it implemented SFAS-106 for regulatory accounting purposes effective January 1, 1991.

2. The cost basis of the pay-as-you-go amounts that supported the rates in effect on the initial date that the carrier became subject to price cap regulation:

The initial rates under price caps were based on the revenue requirement filed by Ameritech in the 1990 annual tariff filing. The revenue requirement included the interstate pay-as you-go expense for OPEB of $47,265,000 along with the associated rate base expense impacts. Since Ameritech has been under price caps, there has been no adjustment in the price cap related indexes for additional pay-as-you go costs.

3. The effect of the price cap formula on that amount up to the date of conversion to SFAS-106:

The price cap formula had no effect. Price caps became effective January 1, 1991 -- the same date on which Ameritech implemented SFAS-106.

4. The carrier's actual cash expenditures related to SFAS-106 for each year since the implementation of price caps, but prior to the implementation of SFAS-106 accounting methods:

Price caps and SFAS-106 were implemented on the same date -- January 1, 1991.

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[3] Letter to Mr. Kenneth Moran, Chief, Accounting and Audits Division, Common Carrier Bureau, FCC, from Walter J. Wagner, Director, Federal Regulatory Accounting, Ameritech Services, Inc., dated January 30, 1992.

5. The treatment of these costs in reports to the Securities and Exchange Commission (SEC) and to shareholders, including specific citations to, or excerpted materials from, such reports to indicate the amount of liability each party has projected for OPEBs:

In its 1991 Form 10-K filing with the SEC, Ameritech Corporation referenced its 1991 Annual Report in which it estimated TBO as of January 1, 1993, to be approximately $2.5 billion before income taxes. Similarly, the SEC Form 10-K reports filed by the individual Ameritech Operating Companies disclosed an estimate of their individual costs for the TBO. Excerpts are included as Exhibit 5 of Attachment A hereto, Ameritech's Direct Case in CC Docket 92-101, filed June 1, 1992, ("Original Direct Case") which is incorporated in its entirety as part of this filing. Attachment H includes excerpts from Ameritech Corporation's Annual Report and the 1992 10-K filings of the individual Ameritech Operating Companies discussing the TBO amounts associated with Ameritech's decision to adopt SFAS-106 effective January 1, 1992, for external financial reporting purposes and to take an immediate charge to income (net of deferred income tax benefit).

OPEB Amounts

1. Describe each type of benefit being provided that is covered by the SFAS-106 accounting rules.

The SFAS-106 accounting rules affect the postretirement medical and dental benefits, Medicare part B reimbursement plan and group life insurance benefits provided to retirees, their dependents and beneficiaries. The specific medical benefit plans are: comprehensive health plan, medical expense plan, health maintenance organizations, dental plan, and prescription drug plan.

2. Provide, on a year-by-year basis, what the pay-as-you-go amounts would have been had the company not implemented SFAS-106 methods.

For 1991, OPEB expenses for the Ameritech Operating Companies and Ameritech Services, Inc., would have been $237,652,000. Pay-as-you-go capital would have been $8,572,000. For 1992, expenses equaled $247,052,000, while the capitalized amount was $6,936,000. In 1993, the corresponding amount would have been 255,199,000, while the capitalized amount would have been $16,173,000.

3. Describe the forms of postretirement benefit accrual accounting, if any, that were utilized before the effective date of price cap regulation.

Ameritech did not adopt any accrual accounting for OPEBs prior to the adoption of price caps. Ameritech did expense and pay an annual cash contribution to the VEBA trust based on an actuarially determined amount. (See also Response E, infra.) It also separately expensed, on a pay-as-you go basis, the OPEB costs of retirees in those years in which those expenses were not paid through the VEBA trust.

4. Describe the type and provide the level of SFAS-106 type expenses reflected in rates before they were adjusted for any exogenous treatment related to SFAS-106.

See first answer #2 and second answer #1, supra.

5. Provide the level of SFAS-106 expenses that were reflected in the rates in effect on the initial date that the carrier became subject to price cap regulation.

See first answer #2, supra.

* * * * * * * *

Issue B:

Should exogenous claims be permitted for SFAS-106 costs incurred prior to January 1, 1993, the Commission's date for mandatory compliance?

Response B:

While Ameritech implemented SFAS-106 effective January 1, 1991, they are seeking exogenous cost treatment only for amounts amortized on and after January 1, 1993. See also pp. 5-10 of Ameritech's Original Direct Case.[4]

* * * * * * *

Issue C:

Have AT&T and the individual LECs correctly and reasonably allocated and separated amounts associated with implementation of SFAS-106 in accordance with the Commission's rules and Responsible Accounting Officer (RAO) letters?

Response C:

1. The amount associated with implementation of SFAS-106 for the total company (including telephone operations and non-telephone operations):

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[4] Note: The Original Direct Case advocated exogenous treatment for TBO amortization amounts for both retirees and active employees. In its Tariff Transmittal No. 702 effective July 2, 1993, (included herewith as Attachment C) Ameritech took exogenous treatment only for TBO amounts for retirees.

The original TBO allocated to the Ameritech Operating Companies and Ameritech Services, Inc. (telephone and non-telephone operations) in connection with the January 1, 1991, implementation of SFAS-106 for regulatory accounting purposes is $2,447,451,000. Pursuant to RAO Letter 20 released May 4, 1992, Ameritech is amortizing these costs over an 18 year period.

2. An explanation of how the carrier arrived at the total company SFAS-106 amounts:

Ameritech employed both Towers Perrin and Actuarial Science Associates to assist in determining the underlying assumptions and in calculating the costs for implementing SFAS-106. The assumptions are based substantially on telephone industry experience, Ameritech's current and historical experience and anticipated trends in economic factors. See also pages 19 and 20 of the Original Direct Case.

3. The amounts allocated to the telephone operating companies, including the specific Part 32 Accounts used and the amounts allocated to each of those accounts.

The amounts allocated to the companies are listed in answer #1, supra. The amounts were recorded on each of the Companies' books in Part 32 Account 4310, "Other Long-Term Liabilities" pursuant to RAO Letter 20. The sub-account 4310.2 "SFAS-106 postretirement benefits" was established to separately track these amounts. A benefit clearing account was established to record the current year's net periodic cost of postretirement benefits, including the 18 year amortization of the TBO. These costs were allocated to the various capital and expense accounts related to the wage and salary amounts charged to the accounts.

4. The methods of allocating amounts to the telephone operating companies (head counts, actuarial studies, etc.):

The amounts were allocated based on head count.

5. The amounts allocated between regulated and non-regulated activities of the telephone companies, with a description and justification of the methodology for the allocations:

The amounts are allocated between regulated and non-regulated by applying the ratio of directly assigned regulated and non-regulated costs.

6. The allocation of costs-to-baskets, by year:

Because "baskets" are related to price cap indexes, these on-going costs are not allocated to baskets as such. It should be noted, however, that SFAS-106 related costs are allocated to the common line category in accordance with the Commission's Part 36 and Part 69 rules.

* * * * *

<u>Issue D:</u>

How should Voluntary Employee Benefit Association trusts or other funding mechanisms for these expenses be treated: (1) if implemented before; (2) if implemented after price caps, but before the change required by SFAS-106; and (3) if implemented after the change in accounting required by SFAS-106?

Response D:

Funding vehicles and appropriate expense amounts should be regarded as separate issues -- especially after the implementation of SFAS-106. Prior to price caps, payments to VEBA trusts were regarded as appropriate expenses. The Commission properly refused to reverse that treatment for baseline price caps rates.[5]

Issue E:

Should exogenous treatment for SFAS-106 amounts be limited to costs that are funded?

Response E:

1. Describe any VEBA trusts or other funding mechanisms for SFAS-106 expenses that were established prior to the adoption of SFAS-106:

In 1988, Ameritech created a Welfare Benefit Trust to fund post retirement health care benefits for current and future retirees. Effective December 29, 1989 the Welfare Benefit Trust was split into the Ameritech Union Welfare Benefit Trust (Union Trust) and the Ameritech Non-Union Welfare Benefit Trust (Non-Union Trust). The accumulated balances in these VEBA accounts were used to reduce the unfunded SFAS-106 obligation as of the date of adoption.

Ameritech also has a Retirement Funding Account (RFA) for providing group life insurance benefits. The RFA is a retired life reserves

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[5] See, In the Matter of Treatment of Local Exchange Carrier Tariffs Implementing SFAS "Employers Accounting for Postretirement Benefits Other Than Pensions," CC Docket No. 92-101, Memorandum Opinion and Order, FCC 93-47 (released January 22, 1993) 8 FCC Rcd. 1024 at n. 116, citing LEC Price Cap Reconsideration Order, 6 FCC Rcd. 2637 at ¶ 59-63.

account established for the purpose of providing qualified basic life insurance for retired employees other than retired key employees. The RFA balances are allocated to separate accounts maintained by the insurance carriers with whom these reserves are held. The balances in these accounts were used to reduce the unfunded SFAS-106 obligation as of the date of adoption.

2. Provide the amounts, placed in these funds for each year since they were implemented, including the 1990-91 tariff year for LECs and the 1989-90 tariff year for AT&T:

3. Describe and provide the amounts in the trust that were for on-going OPEBs and those that were for TBO:

Amounts contributed to VEBA trusts for the Ameritech Operating Companies and Ameritech Services, Inc., for both prefunding of future claim (no payments are made specifically for TBO) are as follows:

	Prefunding (000)	Current Retiree Claims (000)	Total (000)
1988	40,278	0*	40,278
1989	46,682	0*	46,682
1990**	103,573	112,804	216,341
1991**	88,203	135,715	223,918
1992	78,580	159,892	238,472
1993	163,365	0*	163,365
1994	140,889	0*	140,889

(These amounts do not include payments for Medicare part B and group life insurance benefits.)

* Payment of current claims handled via separate non-VEBA account.
** Figures for Ameritech Services, Inc., not available.

4. Describe the assumptions made when the funds were set up, including, but not limited to, the time value of money, expected long-term rate-of-return on plan assets, future compensation levels, and retirement age factors affecting the amount and timing of future benefits:

The Ameritech Welfare Benefit Trust was established in 1988. The following assumptions were used in determining the 1988 funding contribution for the VEBA:

Interest Rate: 9% in 1988 declining to 6.0% in 2001, then reduced by 28% to reflect Unrelated Business Income Tax on trust earnings.

Expected Long-Term Rate-of-Return: N/A for funding calculation.

Future Compensation Level: N/A for medical benefits.

Retirement Rates: Based on industry-wide experience 1975-1978, separate for management and non-management. These figures are displayed in Attachment G.

5. State the purpose of the VEBA funds and describe what SFAS-106 benefits packages are covered by each VEBA fund:

The VEBA funds are used to pay medical, dental and prescription drug benefits as covered under the Ameritech Welfare Benefit Umbrella Plan to current and future Ameritech retirees and their dependents. The specific medical benefit plans are: comprehensive health care plan, medical expense plan, health maintenance organizations, dental plan and Caremark prescription drug plan.

6. Describe the restrictions, if any, that prevent these VEBA funds from being used for other than SFAS-106 benefits:

Non-Union Trust - Per Supplement A of the Ameritech Non-Union Welfare Benefit Trust: Benefits are payable under the Ameritech Welfare

Benefit Umbrella Plan Document (which describes covered medical and dental benefits) to or on behalf of retired non-union employees and their spouses and dependents, but excluding retirees who are "key employees" as that term is defined in section 416(i) of the Code, and spouses and dependents of such key employees.

Union Trust - Per Supplement A of the Ameritech Union Welfare Benefit Trust: Benefits are payable under the Ameritech Welfare Benefit Umbrella Plan Document (which describes covered medical and dental benefits) to or on behalf of retired union employees and their spouses and dependents, by excluding retirees who are "key employees" as that term is defined in section 416(i) of the Code, and spouses and dependents of such key employees. A union employee or former union employee means any employee or former employee who is or was covered by a collective bargaining agreement that provides for the payment of postretirement medical benefits, and in addition shall also mean any other employees or former employees whose positions are or were subject to automatic wage progression or whose pay is or was not at a monthly or annual employees shall not at any time constitute more than 10 percent of the total number of beneficiaries of the Union Trust.

* * * * *

<u>Issue F:</u>

Should exogenous treatment be given only for amounts associated with employee interests that have vested?

Response F:

SFAS-106 benefits are not required to "vest" as pension benefits do as defined by ERISA. An employee does not earn a nonforfeitable right to a retiree medical benefit after satisfying a certain service requirement. Ameritech employees become eligible to receive SFAS-106 benefits after meeting specific age and service requirements (age + service = 75 years for management employees (effective 5/1/95); reaching service pension eligibility for non-management employees). However, continuing coverage for retirees and dependents is subject to review of the overall plan design and cost of maintaining the plan by the Company. The Company reserves the right to amend or terminate the plan at any time. Thus, employee interests in OPEBs never truly "vest" in the traditional sense of that term. Nonetheless, exogenous treatment is appropriate because the accruals in question are consistent with reasonable and prudent business practices.

* * * * *

Issue G:

How should the deferred tax benefit applicable to OPEBs be treated for purposes of exogenous adjustments?

Response G:

The deferred tax benefit applicable to OPEBs should be treated according to the Commission's existing Part 65 Rules. According to section 65.830: the following items shall be deducted from the interstate rate base:

(1) The interstate portion of deferred taxes (Accounts 4100 and 4340).

* * * * *

Supporting Studies and Models

Ameritech includes with this filing, in addition to Attachments A and C previously mentioned, the following material:

- Attachment B, Ameritech Operating Companies' Reply to Oppositions to their Direct Case, filed July 31, 1992, in CC Docket 92-101.

- Attachment D, Opposition to Petitions to Reject or in the Alternative, Suspend and Investigate, filed May 10, 1993, in support of Ameritech's Transmittal No. 702.

- Attachment E, Ameritech Response to Designated Issues for Investigation, filed July 27, 1993, in CC Docket No. 93-193.

- Attachment F, Ameritech Response to Oppositions to Direct Case, filed September 10, 1993, in CC Docket No. 93-193.

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Miscellaneous Supporting Information

Information as to Ameritech's average total compensation per employee and the amount of total compensation represented by OPEBs for calendar 1993 and comparable figures for the U.S. economy are shown in Attachment I.

Accruals for OPEBs should be treated like any other expense item for price cap purposes. Once the cost is properly included in the price cap "base," further changes in the level of that cost -- both increase and decreases --

should be treated like other cost changes that are "within the carrier's control" -- i.e., as endogenous cost changes.

Respectfully submitted,

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Dated: August 14, 1995

Attachment A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Treatment of Local Exchange Carrier Tariffs	)	CC Dkt. No. 92-101
Implementing Statement of Financial	)	
Accounting Standards, "Employers	)	
Accounting for Postretirement Benefits	)	
Other Than Pensions"	)	

DIRECT CASE OF THE AMERITECH OPERATING COMPANIES

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SUMMARY

In this direct case, the Companies demonstrate that the Commission should grant exogenous treatment for the incremental costs of implementing the Statement of Financial Accounting Standards - 106 (SFAS - 106) which the local exchange carriers (LECs) are required to implement by January 1, 1993. Moreover, the Companies demonstrate that their price cap indices (PCIs), resulting from the exogenous treatment of SFAS - 106 costs are just and reasonable.

SFAS - 106 meets the Commission's requirements for exogenous treatment of the incremental costs which the LECs will incur in implementing the change in accounting standards. First, LECs have no control over recognition of these cost changes -- FASB has required LECs to record these costs (which the Commission subsequently authorized) and the Commission has ordered the manner in which LECs may amortize them. Second, the Commission already has determined in the *SFAS - 106 Adoption Order* that the implementation of SFAS - 106 is compatible with regulatory accounting needs. Third, SFAS - 106 is approved by FASB and must be adopted by LECs by January 1, 1993.

Finally, there is no double counting if the Commission grants exogenous treatment for these cost changes, because the full impact of SFAS - 106 will not be reflected in the GNP-PI. A study conducted by Godwins, Inc. (Godwins study) demonstrates that only a small portion of the impact of implementing SFAS - 106 will be reflected in the GNP-PI. The Godwins study concludes that the GNP-PI, by a conservative measure, will reflect only 0.7 percent of the LECs' cost changes due to SFAS - 106. However, the Godwins study also concludes that the general wage rate will be lower over time than it otherwise would have been due to the implementation of SFAS - 106. This

overall decrease in the relative wage level at some future period would allow LECs to recover an additional 14.5 percent of their costs of implementing SFAS - 106, if they can achieve the full benefit of the wage reductions. Consequently, a full 84.8 percent of the LECs' direct incremental SFAS - 106 costs will not be recovered under price caps unless exogenous cost treatment is authorized. The Companies assess this to be a conservative estimate of the level of recovered expenses since the change in overall wages is speculative and achieved cumulatively over future periods. Therefore, they believe that this level of recovery of SFAS - 106 costs should be the minimum granted as an exogenous change.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other Than Pensions"	)))))))	CC Dkt. No. 92-101

DIRECT CASE OF THE AMERITECH OPERATING COMPANIES

The Ameritech Operating Companies (Companies),[1] pursuant to §1.411 of the Federal Communications Commission's (Commission) Rules, 47 C.F.R. § 1.411, respectfully submit this direct case as required by the Commission in its *Order of Investigation and Suspension*.[2] In this direct case, the Companies demonstrate that the Commission should grant exogenous treatment for the incremental costs of implementing the Statement of Financial Accounting Standards - 106 (SFAS - 106) which the local exchange carriers (LECs) are required to implement by January 1, 1993.[3] Moreover, the Companies demonstrate that their price cap indices (PCIs), reflected in the illustrative tariff attached as Exhibit 1, resulting from the exogenous treatment of SFAS - 106 costs are just and reasonable.

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[1] The Ameritech Operating Companies are: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Inc., Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

[2] *Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other Than Pensions,"* CC Dkt No. 92-101, *Order of Investigation and Suspension*, DA 92-540, 7 FCC Rcd. (released April 30, 1992) (*Investigation Order*).

[3] Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 106, December 1990 (SFAS - 106).

I. Background

In December 1990, the Financial Accounting Standards Board (FASB) adopted SFAS - 106 which establishes new financial accounting and reporting standards for an employer that offers postretirement benefits provided other than pensions (OPEBs) to its employees. OPEBs are those benefits outside of the pension plan provided by employers to retirees, their beneficiaries and covered dependents. OPEBs generally include health and dental benefits and life insurance.

SFAS - 106 requires companies to change from the cash basis of accounting ("pay-as-you-go") for these benefits to the accrual basis of accounting for them. SFAS - 106 requires OPEBs to be recognized as a form of deferred compensation, and requires companies to recognize the cost of providing these benefits to each employee as the employee provides service to the employer. In addition to the change to accrual accounting on a prospective basis under SFAS - 106, companies must also recognize the amount of their unfunded obligation for these benefits to retirees and active employees existing as of the date of adoption of the statement. This unfunded obligation is referred to as the transition benefit obligation (TBO). SFAS - 106 permits companies whose plans have active plan participants to either recognize the TBO as an immediate expense or defer and amortize it over the average remaining service period of active plan participants. However, if the average remaining service period is less than 20 years, then the employer may elect to use a 20-year period.

On December 26, 1991, the Commission issued an *SFAS - 106 Adoption Order* authorizing all LECs subject to SFAS - 106 to implement the new financial accounting standards on or before January 1, 1993.[4] Since 1985, the Commission has implemented a policy of following generally accepted accounting principles (GAAP) unless adoption of a principle or practice conflicts with regulatory objectives.[5] In the *SFAS - 106 Adoption Order*, the Commission found that the adoption of SFAS - 106 by the LECs would not conflict with its regulatory objectives and therefore SFAS - 106 was a mandatory practice under the Uniform System of Accounts (USOA).[6] However, noting that an immediate recognition of the TBO would be so large as to distort LECs' operating results, the Commission ordered that the TBO be deferred and amortized over a 20 year period or over the average remaining service period of active participants, as permitted by SFAS - 106.

On January 30, 1992, the Ameritech Operating Companies notified the Commission, as required by § 32.16 of the Commission's rules, 47 C.F.R. § 32.16, and the *SFAS - 106 Adoption Order*, that they implemented SFAS - 106 as of January 1, 1991 for regulatory accounting purposes.[7] In their notification letter, the Companies provided an estimate of their annual incremental revenue requirements for the calendar years 1991 through 1994.

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[4] *Southwestern Bell and GTE Service Corporation, Notification of Intent to Adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions*, 6 FCC Rcd 7560 (1991) (*SFAS - 106 Adoption Order*).

[5] *Revision of the Uniform System of Accounts for Telephone Companies to Accommodate Generally Accepted Accounting Principles*, 102 FCC 2d 964, 50 F.R. 48,408 (released November 25, 1985).

[6] *SFAS - 106 Adoption Order* at ¶ 3.

[7] Letter to Mr. Kenneth Moran, Chief, Accounting and Audits Division, Common Carrier Bureau, FCC, from Walter J. Wagner, Director, Federal Regulatory Accounting, Ameritech Services, Inc., dated January 30, 1992.

Pursuant to the *SFAS - 106 Adoption Order*, Bell Atlantic, US West and Pacific Bell filed tariffs with the Commission seeking exogenous cost treatment for the incremental costs associated with implementing the new financial accounting and reporting requirements under SFAS - 106.[8] They argue that these incremental costs should receive exogenous treatment under the Commission's price caps rules because recognition of these cost changes is: a) beyond the LECs' control; b) consistent with the Commission's regulatory accounting policy; c) approved and effective; and d) not fully reflected in the GNP-PI.

In response to these tariff filings the Commission issued an *Investigation Order* in the above captioned matter. In the *Investigation Order*, the Commission found that the threshold issue raised by each of the tariffs -- whether the cost of implementing SFAS - 106 should be treated exogenously -- is common to all price caps carriers. Moreover, the Commission found that the resolution of that issue, as well as other issues raised by the tariffs, would require thorough analysis and review of complicated econometric studies and reasoning. It also concluded that the issues would be resolved best by full participation of interested parties through a notice and comment proceeding. Thus, the Commission made all LECs subject to price caps (whether or not a they had filed a tariff) parties to the *Investigation Order* and required them to submit a direct case by providing the specific information outlined in the *Order*.[9]

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[8] Bell Atlantic Tariff F.C.C. No. 1, Transmittal No. 497, filed February 28, 1992; US West Communications, Inc. Tariff F.C.C. Nos. 1 and 4, Transmittal No. 246, filed April 3, 1992; and Pacific Bell Tariff F.C.C. No. 128, Transmittal No. 1579, filed April 16, 1992.

[9] *Investigation Order* at 3-4.

II. Direct Case

Pursuant to the *Investigation Order,* the Ameritech Operating Companies respectfully submit this direct case. The Companies implemented SFAS - 106 as of January 1, 1991, and intend to file a tariff which would reflect exogenous treatment for the incremental expenses the Companies will recognize as a result of these new financial accounting and reporting standards. An illustrative tariff has been attached which shows the calculation of the new PCIs assuming exogenous treatment for these costs. In support of both exogenous cost treatment and the amount of incremental expense which the Companies propose to recognize, the Companies submit the following information.

A. Issues Designated For Investigation

1. **Have the LECs borne their burden of demonstrating that implementing SFAS - 106 results in an exogenous cost change under the Commission's price caps rules?**

Section 61.44(c) provides the circumstances under which the Commission will consider allowing exogenous treatment for certain cost changes. 47 C.F.R. § 61.44(c). Specifically, the rules allow exogenous cost treatment for, among other things, cost changes caused by changes in the Uniform System of Accounts and other extraordinary cost changes as the Commission will permit or require. 47 C.F.R. § 61.44(c)(2) and (5).

The Commission identified in its price caps orders the following requirements for obtaining exogenous treatment of costs resulting from a change in GAAP: a) the change is imposed by the Commission and is beyond the control of the carrier; b) the change is compatible with regulatory accounting needs; and c) FASB has approved the change and it has become effective.[10] Moreover, to obtain exogenous treatment, the Commission must be assured that the GAAP change is not so universal that it would be reflected in the inflation measure thereby resulting in double counting within the context of the PCI.[11]

SFAS - 106 meets the Commission's requirements for exogenous treatment of the incremental costs which the LECs will incur in implementing the change in accounting standards. First, as noted above, the FASB has ordered that all companies providing OPEBs implement the new financial accounting and reporting standards no later than the fiscal years beginning after December 15, 1992. Moreover, the Commission has authorized the adoption of SFAS - 106 and ordered that the TBO be amortized over a substantial number of years. Clearly, LECs have no control over recognition of these cost changes -- FASB has required LECs to record these costs (which the Commission subsequently authorized) and the Commission has ordered the manner in which LECs may amortize them. Second, the Commission already has determined in the *SFAS - 106 Adoption Order* that the implementation of SFAS - 106 is compatible with regulatory accounting needs. Third, SFAS - 106 is approved by FASB and must be adopted by LECs by January 1, 1993. Thus, these costs are not merely anticipated expenses, but must be recognized on the books of the LECs by an established date.

Finally, there is no double counting if the Commission grants exogenous treatment for these cost changes, because the full impact of SFAS - 106 will not be reflected in the GNP-PI. As more fully explained below, a study

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10 *Policy and Rules Concerning Rates for Dominant Carriers*, CC Dkt. No. 87-313, 5 FCC Rcd. 6786, 6807, and *Erratum*, 5 FCC Rcd. 7664 (1990), *modified on recon.*, 6 FCC Rcd. 2637, 2665 (1991).

11 *Id.* at 2665.

conducted by Godwins, Inc. (Godwins study) demonstrates that only a small portion of the impact of implementing SFAS - 106 will be reflected in the GNP-PI. On a simplistic level, the GNP-PI will not reflect fully the implementation of SFAS - 106 because not all companies are required to implement the accounting change since they do not provide OPEBs, and not all companies that provide OPEBs provide the same level of benefits. The Godwins study concludes that the GNP-PI, by a conservative measure, will reflect only 0.7 percent of the LECs' cost changes due to SFAS - 106. However, the Godwins study also concludes that the general wage rate will be lower over time than it otherwise would have been due to the implementation of SFAS - 106. This overall decrease in the relative wage level at some future period would allow LECs to recover an additional 14.5 percent of their costs of implementing SFAS - 106, if they can achieve the full benefit of the wage reductions. Consequently, a full 84.8 percent of the LECs' direct incremental SFAS - 106 costs will not be recovered under price caps unless exogenous cost treatment is authorized. The Companies assess this to be a conservative estimate of the level of unrecovered expenses since the change in overall wages is speculative and achieved cumulatively over future periods. Therefore, they believe that this level of recovery of SFAS - 106 costs should be the minimum granted as an exogenous change.

2. If these cost changes are treated as exogenous: a) should costs associated with the implementation of SFAS - 106 prior to January 1, 1993, be treated as exogenous; b) are the assumptions made by the individual LECs in calculating these costs reasonable; c) given these assumptions, have the individual LECs correctly computed the exogenous cost changes; and d) are the individual LEC allocations of these costs among the price cap baskets consistent with Commission rules?

While the Companies implemented SFAS - 106 effective January 1, 1991, they are not seeking exogenous cost recovery until January 1, 1993. Moreover,